South Carolina Legislative Audit Council

LAC

Report to the General Assembly

March 2000

A Review of the Charleston Naval Complex Redevelopment Authority's 1999 Lawsuit Settlement With Braswell Services Group

Legislative Audit Council

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A Review of the Charleston Naval Complex Redevelopment Authority's 1999 Lawsuit Settlement With Braswell Services Group was conducted by the following audit team.

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A Review of the Charleston Naval Complex Redevelopment Authority's 1999 Lawsuit Settlement With Braswell Services Group

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Synopsis

We reviewed a December 1999 lawsuit settlement in which the Charleston Naval Complex Redevelopment Authority (RDA) agreed to pay $4 million to a ship repair company called Braswell Services Group, Inc.

Since 1994, the RDA has been responsible for redeveloping property at the former Charleston Naval Base, which was closed in 1996. Because the Navy still owns the base, the RDA enters into master leases with the Navy and then subleases the properties to other organizations. One of the primary goals of the RDA is to replace the jobs lost by the closing of the base.

History of the Lawsuit

In a March 1997 agreement, Braswell Services Group, Inc., agreed to drop prior legal actions against the RDA and the State Budget and Control Board regarding the manner in which the RDA awarded subleases for piers and buildings. In exchange, the RDA agreed to give Braswell a sublease for a pier and several buildings at the naval complex after the RDA entered into a master lease with the Navy for the properties.

In June 1997, the Navy submitted a master lease to the RDA that Navy officials were prepared to sign for the properties sought by Braswell. The RDA, however, never signed the master lease with the Navy or a sublease with Braswell. The RDA stated that it did not sign these leases because Braswell had not obtained or applied for certain environmental permits. Also, the RDA stated that until it signed a master lease with the Navy, it was not required to sign a sublease with Braswell.

Braswell contended that it was entitled to a sublease because the Navy had approved the master lease and that environmental permits were not a prerequisite. In October 1997, Braswell sued the RDA for breach of contract.

Findings

- There is evidence that the RDA complied with a literal interpretation of the March 1997 agreement. However, a reasonable argument can be made that the agreement required the RDA to sign a master lease with the Navy and a sublease with Braswell after the Navy submitted a master lease it was prepared to sign.

- There were valid reasons for the RDA's December 1999 decision to settle its lawsuit with Braswell Services Group out of court, although it is not clear how the RDA determined that $4 million was an appropriate amount for the settlement.

- The RDA agreed to the $4 million settlement without obtaining prior written approval of the State Budget and Control Board, as required by the South Carolina Code of Laws.

Background

Audit Objectives

Members of the General Assembly asked us to review the administration of the Charleston Naval Complex Redevelopment Authority (RDA). We are addressing their concerns in this limited-scope audit report and also in a full-scope audit report which will be published later this year.

Objectives of This Audit

We reviewed an October 1997 lawsuit filed by Braswell Services Group, Inc., a ship repair company, against the RDA for violating the terms of a prior agreement. The lawsuit was settled in December 1999 after the RDA agreed to pay Braswell $4 million in damages.

In January 2000, members of the Charleston legislative delegation held a public hearing to air concerns about the Braswell lawsuit settlement and to receive testimony from the Redevelopment Authority. During the hearing, an audit requester expressed the need for immediate information on the lawsuit settlement. In response, we are releasing this audit ahead of the full-scope report. We answered the following questions in this audit:

- ❑ What was the primary issue in dispute between the RDA and Braswell?
- ❑ Did the RDA have valid reasons for its December 1999 decision to pay Braswell $4 million to settle the lawsuit?
- ❑ Did the RDA obtain the approval required by state law before agreeing to pay Braswell the $4 million settlement?

Objectives of the Audit That Will Be Published Later This Year

Later this year, we will publish a report addressing whether the RDA has:

- ❑ Complied with state rules and regulations regarding subleases of properties at the naval complex.
- ❑ Adhered to sound business practices regarding subleases of properties at the naval complex.
- ❑ Maintained a proper relationship with the South Carolina State Ports Authority, consistent with the statutory mission of the RDA.

- ❑ Implemented an adequate system for safeguarding equipment and furniture owned by the U.S. Navy.
- ❑ Complied with the Freedom of Information Act.

Scope and Methodology

The period covered during this audit was primarily 1997 through 1999. Our primary sources of evidence included:

- ❑ Relevant South Carolina laws.
- ❑ The 1997 agreement between the RDA and Braswell to settle previous lawsuits and protests filed by Braswell in 1995 and 1996.
- ❑ Braswell's October 1997 lawsuit against the RDA alleging breach of the 1997 settlement agreement.
- ❑ The 1999 agreement of the RDA to pay $4 million to settle the lawsuit filed by Braswell in 1997.
- ❑ Other relevant court documents.
- ❑ RDA correspondence and financial reports.

In addition, we interviewed officials with the RDA, the U.S. Navy, and the South Carolina State Budget and Control Board.

This audit was conducted in accordance with generally accepted government auditing standards.

Background and History

The Charleston Naval Base dates back to 1901 and comprises 1,574 acres located in the City of North Charleston, with almost 4.5 miles of shoreline on the Cooper River. During World War II, it grew to become a major Navy port. But in 1988, under the federal Defense Base Closure and Realignment Act, the Department of Defense started closing selected military installations around the country. The Charleston Naval Base was targeted for closure in 1993, and full closure occurred in 1996. According to the U.S. Department of Defense, this resulted in the loss of 6,272 civilian and 8,722 military jobs at the base.

Reuse planning for the base began in 1993 with the BEST Committee (Building Economic Solutions Together), which was formed by executive order of the Governor and included representatives from Charleston, Dorchester, and Berkeley Counties (known as the Trident Region). In 1994, the S.C. General Assembly passed the Military Facilities Redevelopment Law, finding that:

> . . . federal property located in the State has and will become available for the state's use. It is in the best interests of the citizens of this State for the State, municipalities, and counties to work in concert and oversee and dispose of federal military facilities and other excess federal property, in an orderly and cooperative manner. (§31-12-20(1))

The act authorized the Governor to create separate and distinct redevelopment authorities. In 1994 by executive order the Governor created the Charleston Naval Complex Redevelopment Authority (RDA), and the BEST Committee was phased out.

The Authority's purpose is to oversee the redevelopment and reuse of the real and personal federal property at the Charleston naval complex. (Real property consists of land, buildings and other structures; personal property consists primarily of equipment, furniture, and vehicles.) The Authority is currently composed of seven members — a chairman appointed at-large by the Governor; three members from the City of North Charleston; and one member each from Charleston, Dorchester, and Berkeley Counties. The Authority has a staff of 16, and is funded by money from the U.S. Navy, federal grants, state redevelopment funds, leases, and miscellaneous revenues.

The Leasing Process

The U.S. Navy currently holds title to the land at the naval complex. Actual conveyance of part of the complex to the state is expected to begin in late spring 2000.

In the interim, the RDA is leasing land and buildings to private businesses and non-profit groups. Some federal and state agencies are also tenants at the naval complex. When the RDA finds a suitable tenant for property located at the complex, it first obtains a master lease with the Navy and then subleases the property to the tenant. Both the State Budget and Control Board and the U.S. Navy must approve all leases for property at the naval complex.

As of February 2000, 69% of the former Navy facilities were leased, licensed, or federally-owned or occupied; this includes buildings, piers, and dry docks. Also in February 2000 the RDA reported that 4,207 individuals were employed by businesses and agencies located at the naval complex.

State law authorizes the RDA to:

- Make and amend by-laws, rules, and regulations.
- Sue and be sued.
- Make and execute contracts.
- Carry-out redevelopment projects.
- Purchase, acquire, improve, sell, exchange, transfer, mortgage, retain for its own use or otherwise encumber or dispose of any real or personal property within its area of operation.

The RDA is also authorized to issue bonds and borrow money, provided it does not pledge the full faith and credit of the state or any political subdivision for repayment. The RDA must comply with the provisions of the S.C. Consolidated Procurement Code. The RDA may dissolve when all properties have been sold to the private sector or if the Authority decides to transfer any remaining redevelopment property to another public body or successor entity.

Findings

Overview of the October 1997 Lawsuit Filed by Braswell Against the RDA

In 1995 and 1996, Braswell Services Group, Inc., a ship repair company, filed four lawsuits and four procurement protests against the State Budget and Control Board and the RDA regarding the manner in which the RDA awarded subleases for piers and buildings.

In March 1997, Braswell, the Budget and Control Board, and the RDA signed a settlement agreement in which Braswell agreed to dismiss the lawsuits and withdraw the procurement protests. In exchange, the RDA gave Braswell a six-month "license" to set up a ship repair facility at Pier Alpha and several buildings at the north end of the naval complex. The RDA also agreed that it would execute a sublease agreement with Braswell to begin ship repair operations:

> The RDA hereby agrees to execute a [Sub]lease Agreement . . . with Braswell for facilities listed in the aforesaid Lease at the Charleston Navy Base, and under the terms and conditions as set forth in the aforesaid Lease. The RDA will enter into a Sublease with Braswell not later than 48 hours after the RDA enters into a Master Lease with the Navy.

After the March 1997 agreement was finalized, Braswell started to set up its ship repair facility at the complex. In June 1997, the U.S. Navy approved RDA's application for a master lease for the properties that Braswell sought to sublease. In conjunction with its approval of the RDA's application, the Navy delivered a master lease to the RDA that Navy officials were prepared to sign. The RDA, however, did not sign the master lease with the Navy or a sublease with Braswell.

At the end of September 1997, three months after the Navy submitted a master lease to the RDA for the properties sought by Braswell, the RDA had not signed either the master lease with the Navy or a sublease with Braswell. In October 1997, Braswell vacated the property and sued the RDA for violating the terms of the March 1997 agreement. This agreement, in Braswell's view, required the RDA to sign the master lease after it had been approved by the Navy and to then sign a sublease with Braswell.

The case went to trial in December 1999. At the beginning of the trial, the court made evidentiary and other rulings that increased the likelihood that Braswell would win its case. Under a settlement order issued by the court and after an agreement between the two parties, the RDA agreed to pay Braswell $4 million. According to the RDA, the settlement will be paid to Braswell using redevelopment fees from the S.C. Department of Revenue.

What Was the Primary Issue in Dispute Between the RDA and Braswell?

The primary issue in dispute between the RDA and Braswell was how to interpret language in their March 1997 lawsuit settlement agreement, which stated:

> The RDA hereby agrees to execute a [Sub]lease Agreement . . . with Braswell . . . . The RDA will enter into a Sublease with Braswell not later than 48 hours after the RDA enters into a Master Lease with the Navy.

The RDA never signed a master lease with the Navy or a sublease with Braswell. The RDA contended that, under a literal interpretation of the agreement:

- The phrase "enters into a Master Lease with the Navy" meant a master lease *signed* by the RDA and the Navy.
- Until a master lease was signed, the RDA was not required to enter into a sublease with Braswell.
- There was no time period in the agreement within which the RDA had to enter into a master lease with the Navy.

The RDA indicated that it would not sign a sublease with Braswell because Braswell had not obtained or applied for environmental permits needed to repair ships. In a July 2, 1997, letter to Braswell, the RDA board chairman stated:

> As you know, the agreement to [sub]lease Pier Alpha and other properties to [Braswell] is contingent upon [Braswell] obtaining approval of all permits. Considering that [Braswell] will be using the premises exclusively as a ship repair operation facility, [Braswell] is required to obtain air, water and discharge permits. [Braswell] will also have to obtain permission to amend the existing permit held by the [RDA] in order to dredge a site for the dry docks and perform maintenance dredging.

There was no stipulation or language in the March 1997 agreement that required Braswell to obtain or apply for environmental permits as a prerequisite to the sublease.

In a September 16, 1997, letter to Braswell, the RDA's attorney stated:

> . . . [P]ermits are a pre-requisite to the consummation of a [sub]lease between Braswell and the Authority.

On September 26, 1997, three months after the Navy approved the master lease and four days before Braswell's license for the property expired, the RDA's attorney sent a letter to Braswell, stating:

> The license under which Braswell is presently occupying facilities on the Charleston Naval Complex expires on September 30, 1997. . . . On or before September 30, 1997, Braswell must demonstrate that it has obtained all permits necessary to operate its ship repair business. Alternatively, Braswell may provide copies of . . . documents demonstrating that it has begun the process of applying for necessary permits. If Braswell takes the position that it may operate its ship repair business without permits, please provide me with copies of correspondence from regulatory agencies which verify that claim.

Braswell sued the RDA on October 1, 1997. In its lawsuit, Braswell contended that:

- Its sole obligation in the March 1997 agreement was to drop the previous lawsuits and protests.
- The agreement obligated the RDA to sign a sublease with Braswell after the Navy delivered a master lease to the RDA that Navy officials were prepared to sign.
- Certain kinds of ship repair work could begin without permits and that any necessary permits would be obtained.

Navy officials were prepared to sign the master lease when they delivered it to the RDA in June 1997. The Navy expressed no objection to a sublease between the RDA and Braswell. In addition, the Navy did not require that Braswell obtain or apply for environmental permits as a prerequisite to a sublease. There was no stipulation or language in the March 1997 agreement that required Braswell to obtain or apply for environmental permits as a pre-requisite to the sublease.

To summarize, there is evidence that the RDA complied with a literal interpretation of the March 1997 settlement agreement. Under this literal interpretation, however, the RDA could have indefinitely delayed signing a master lease with the Navy, even though the Navy was ready to sign and, thus, could have indefinitely delayed signing a sublease with Braswell. Therefore, a reasonable argument can be made that the March 1997 agreement required the RDA to sign a master lease with the Navy after it was delivered by the Navy, and to then sign a sublease with Braswell.

Did the RDA Have Valid Reasons for Its Decision to Pay Braswell $4 Million?

. . . [I]t is not clear how the RDA determined that $4 million was an appropriate amount for the settlement.

We found valid reasons for the RDA's December 1999 decision to settle its October 1997 lawsuit with Braswell Services Group out of court, although it is not clear how the RDA determined that $4 million was an appropriate amount for the settlement.

The following are valid reasons for the RDA's decision to settle the lawsuit:

- A reasonable argument can be made that the March 1997 agreement required the RDA to sign a master lease with the Navy and a sublease with Braswell after the Navy submitted a master lease it was prepared to sign (see pp. 6, 7).
- The court approved a motion from Braswell to exclude evidence of communications prior to the March 1997 settlement, in which the issue of environmental permits was discussed.
- The court indicated that it was prepared to direct a verdict for Braswell if it could be shown that the RDA would not sign a master lease that the Navy was prepared to sign.
- The potential outcome of a jury trial and the appeals process was uncertain.

In addition, the RDA stated that its interest in settling with Braswell in December 1999 was based on a concern that a large judgement could have delayed transfer of ownership of the naval complex from the Navy to the RDA.

Braswell, in its October 1997 complaint, specified total damages of $1.75 million. In July 1999, Braswell provided to the RDA a consultant's estimate that Braswell could have earned between $2.1 million and $5.7 million in pre-tax profits from July 1, 1997, through June 30, 2002. Braswell also provided documents contending that it had spent approximately $1.5 million to prepare naval complex property for ship repair operations.

We found no documentation that the RDA conducted an analysis to verify or refute the merits of Braswell's damage claims. RDA officials report that the agency's attorney and staff had meetings and discussions, internally and with the plaintiffs and the court, regarding the merits of Braswell's damage claims. However, RDA officials stated they had no documentation of these meetings and discussions. It is therefore not clear how the RDA determined that a $4 million settlement was appropriate.

Did the RDA Obtain the Required Approval Before Agreeing to Pay Braswell $4 Million?

On December 14, 1999, the RDA agreed to the $4 million settlement without obtaining prior written approval of the State Budget and Control Board. Section 11-1-45(A) of the South Carolina Code of Laws states:

> No state agency or instrumentality of the State, excluding the General Assembly, Senate, House of Representatives, local political subdivisions, special purpose districts, and special taxing districts, shall enter into a settlement of any litigation, dispute, or claim over one hundred thousand dollars . . . of public funds without prior written approval from the Budget and Control Board.

The executive director of the State Budget and Control Board reported to the Governor, in a January 8, 2000, letter that the Budget and Control Board:

> . . . did not approve the settlement pursuant to S.C. Code Section 11-1-45. Thus, the RDA did not receive the required written approval from the BCB prior to entering into the settlement.

The executive director of the Budget and Control Board also noted that the settlement had been set forth in an order from the presiding judge. Therefore, Budget and Control Board officials determined that they had no legal authority to retroactively prevent the RDA from paying the settlement to Braswell.

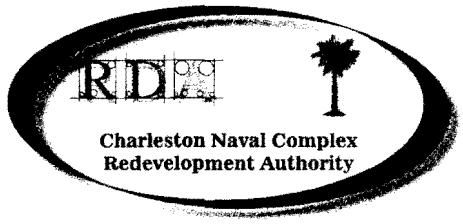
RDA officials stated that, during the settlement negotiations, they were unaware of the requirements of §11-1-45(A). Also, during our review, RDA officials contended that the RDA is a political subdivision and thus is not required to obtain written approval from the Budget and Control Board before agreeing to large legal settlements. Their view is based on an interpretation of the federal Internal Revenue Code by the RDA's attorney in 1996. This interpretation of federal law did not address §11-1-45(A) of the South Carolina Code of Laws.

It is reasonable to conclude that §11-1-45(A) is applicable to the RDA and required it to obtain prior written approval of the Budget and Control Board.

Recommendation

The RDA should comply with §11-1-45 (A) of the South Carolina Code of Laws when entering into lawsuit settlement agreements. If the RDA has any disagreement regarding the applicability of this law, it should seek and rely on the advice of the South Carolina Attorney General.

Agency Comments



March 10, 2000

Mr. George L. Schroeder
Legislative Audit Council
1331 Elmwood Ave., Suite 315
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Re: Final Comments on draft report entitled *A Review of the Charleston Naval Complex Redevelopment Authority's 1999 Lawsuit Settlement with Braswell Services Group.*

Dear Mr. Schroeder:

The Charleston Naval Complex Redevelopment Authority (the "RDA") appreciates the straightforward manner in which your audit is being conducted and we welcome the opportunity to give final comments on your draft report. The General Assembly should be provided a full explanation of the communications between Braswell and the RDA prior to the settlement agreement so that it may understand what the RDA was thinking and why certain actions were taken or not taken. This document will address the draft report on a paragraph by paragraph basis.

Page v *Synopsis*

In a March 1997 agreement, Braswell Services Group, Inc., agreed to drop prior legal actions against the RDA and the State Budget and Control Board regarding the manner in which the RDA awarded subleases for piers and buildings. In exchange, the RDA agreed to give Braswell a sublease for a pier and several buildings at the naval complex after the RDA entered into a master lease with the Navy for the properties.

RDA Comment:

This is an incomplete summary. Braswell Services Group, Inc. agreed to drop prior legal actions against the RDA and the State Budget and Control Board but retained the right to re-institute these actions in the event the RDA did not execute the lease within the time specified, or within some other mutually agreeable time. In addition, Braswell agreed to take such other reasonable steps as may be necessary to fully implement the Settlement Agreement. In exchange, the RDA had to do several things including entering into a License Agreement;

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entering into a sublease with Braswell not later than 48 hours after the RDA entered into a Master Lease with the Navy; and also to take such other reasonable steps as may be necessary to fully implement the Settlement Agreement.

> In June 1997, the Navy submitted a master lease to the RDA for the properties sought by Braswell that Navy officials were prepared to sign. The RDA, however, never signed the master lease with the Navy or a sublease with Braswell. The RDA stated that it did not sign these leases because Braswell had not obtained or applied for certain environmental permits. Also, the RDA stated that until it signed a master lease with the Navy, it was not required to sign a sublease with Braswell.

RDA Comment:

This statement omits that the RDA fully intended to sign a master lease that would have included amendments to address changes required by Braswell. Mr. Tom Feagin testified that it was his understanding that all the RDA required of Braswell was a "comfort letter" from DHEC. The most important facts omitted from the second sentence is that (1) no "mutually agreeable time" was specified for executing the documents; (2) that Braswell did not take reasonable steps to implement the agreement and (3) abandoned the property giving the RDA no opportunity to execute these documents. After September 30, 1999, Braswell was interested only in dollars, not performance.

> The RDA agreed to the $4 million settlement without obtaining prior written approval of the State Budget and Control Board, as required by the South Carolina Code of Laws.

RDA Comment:

The LAC is attempting to interpret the law. We are concerned that an agency of the legislative branch of government is issuing legal opinions and interpreting the law. We also are aware that investigative staffers, not licensed attorneys, are rendering these opinions. A less interpretive statement would be:

"The RDA agreed to the $4 million settlement without obtaining prior written approval of the State Budget and Control Board. State Budget and Control Board approval is required for all state agencies, with the exception of local political subdivisions."

Page 6 **What Was the Primary Issue in Dispute Between the RDA and Braswell?**

The RDA contended that, under a literal interpretation of the agreement:

Until a master lease was signed, the RDA was not required to enter into a sublease with Braswell.

RDA Comment:

The second page of the settlement agreement states that the RDA agreed to execute a Lease Agreement with Braswell and it fully intended to do so. However, we did not anticipate Braswell arbitrarily determining a time schedule and abandoning the property. In the process of doing its due diligence, the RDA was caught by surprise but did not take the position that it did not have to execute a sublease at some point.

Navy officials were prepared to sign the master lease when they delivered it to the RDA in June 1997. The Navy expressed no objection to a sublease between the RDA and Braswell. In addition, the Navy did not require that Braswell obtain or apply for environmental permits as a pre-requisite to a sublease. There was no stipulation or language in the March 1997 settlement that required Braswell to obtain or apply for environmental permits as a pre-requisite to the sublease.

RDA Comment:

It is true that the Navy did not require environmental permits or a permit application as a pre-requisite to a sublease. It is true that the settlement agreement contained no stipulation or language that required permits or a permit application as a pre-requisite to a sublease. However, it is also true that the RDA did not require permits as a pre-requisite to a sublease. This fact is supported by the September 26, 1997 letter from Wilbur Johnson and the testimony of T. R. Feagin.

With kindest regards,

Jack C. Sprott
Executive Director

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